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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 NEA-10 IO-11 H-02 L-03 PA-01

PRS-01 AID-05 CIAE-00 COME-00 EB-07 FRB-03 INR-07

NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02 CIEP-01 LAB-04

SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01 /103 W

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R 170825Z FEB 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 2179

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USADB

E.O. 11652: ADS, DECLAS 8/17/76

TAGS: EAID, EFIN

SUBJECT: REVIEW OF BANK'S RESOURCE POSITION AND PROPOSAL FOR AN
INCREASE IN THE BANK'S CAPITAL STOCK

FOR NAC AGENCIES

PASS TREASURY FOR ZINMAN

REF: MANILA 1540

1. AT MEETING 12 FEBUARY, ADB BOARD OF DIRECTORS
DISCUSSED FOUR WORKING PAPERS PREPARED IN RESPONSE TO
QUESTIONS AND COMMENTS OF DIRECTORS AT DECEMBER 16 MEETING.
ADB PRESIDENT OBSERVED THAT SINCE DIRECTORS HAVE NOT
RECEIVED INSTRUCTIONS FROM THEIR GOVERNMENTS, HE
INVITED DIRECTORS TO DISCUSS OR COMMENT INFORMALLY ON
SIX SPECIFIC ISSUES TO PERMIT BANK STAFF TO BEGIN WORK
ON DRAFT REPORT OF BOARD OF DIRECTORS AND DRAFT
RESOLUTION OF BOARD OF GOVERNORS.

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2. INFORMAL MAJORITY VIEW OF DEVELOPED MEMBER COUNTRY

DIRECTORS ON SIX ISSUES APPEARED TO BE: (A) EARLY ENCASHMENT OF DEMAND NOTES AS PROPOSED BY BANK WITH FRANCE OPPOSED; (B) 135 PERCENT CAPITAL INCREASE, WITH AUSTRALIA UNABLE TO INDICATE WHEN POSITION WOULD BE ESTABLISHED BY NEW GOVERNMENT; (C) 10 PERCENT PAID-IN, WITH JAPAN, SWITZERLAND AND ITALY SUPPORTING 15 PERCENT PROPOSED BY BANK, AND WITH CONCERNS EXPRESSED ABOUT ADEQUACY OF BANK INCOME TO MAINTAIN LENDING RATE; (D) 40 PERCENT OF PAID-IN CONVERTIBLE CURRENCY, WITH CANADIAN DIRECTOR SUGGESTING 50 PERCENT; (E) MID-1977 AS TARGET DATE FOR CAPITAL INCREASE TO COVER ESTIMATED LOAN COMMITMENTS; AND (F) NEED FOR STUDY OF TRIGGER AMOUNTS FOR EFFECTIVENESS OF CAPITAL INCREASE.

3. DEVELOPING MEMBER COUNTRY (DMC) DIRECTORS STRONGLY SUPPORTED NECESSITY TO INCREASE CAPITAL BY 150 PERCENT TO MAINTAIN GROWTH IN ORDINARY LENDING PROGRAM AND TO PROVIDE LOANS TO SPECIAL FUND COUNTRIES IF ADF REPLENISHMENT INADEQUATE, BUT WOULD ACCEPT 10 PERCENT PAID-IN WITH CONTINUATION OF 40 PERCENT CONVERTIBLE CURRENCY PORTION OF PAID-IN. KOREAN DIRECTOR SUGGESTED A SLIGHT INCREASE TO 11.1 PERCENT PAID-IN OR PERCENTAGE SUFFICIENT TO PERMIT BANK TO ACQUIRE \$245 MILLION IN PAID-IN CONVERTIBLE CURRENCY UNDER ARTICLE 6.2(A) AS MINIMUM ESTIMATED BY BANK TO ACHIEVE APPROPRIATE RESERVE/LOAN AND INTEREST COVERAGE RATIOS IN 1981.

4. MAJOR ISSUES RAISED IN DISCUSSION OF WORKING PAPER III FOCUSED ON INADEQUATE BANK LENDING PROGRAM IN RELATION TO DMC REQUIREMENTS AND TO WORLD BANK PROJECTED LENDING PROGRAM IN REGION. SOME DEVELOPED COUNTRY DIRECTORS/ACTING DIRECTORS, MAINLY CANADA AND SWITZERLAND, SUGGESTED THAT A REVIEW OF BANK FINANCIAL INDICATORS IN TWO YEARS COULD RESULT IN INCREASING THE LENDING PROGRAM IF 25 PERCENT SAFETY MARGIN COULD BE REDUCED OR ELIMINATED. OTHER POSSIBILITIES WOULD BE LOWERING RESERVE/LOAN AND INTEREST COVERAGE RATIOS IF BOND PURCHASERS WERE ONLY INTERESTED IN MEMBER GOVERNMENT GUARANTEES.

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5. DISCUSSION OF WORKING PAPER I CONCENTRATED ON FINANCIAL INDICATORS, PRIMARILY RATIONALE FOR 25 PERCENT SAFETY MARGIN. ADB PRESIDENT SAID THAT FINANCIAL UNCERTAINTIES REQUIRE CONTINUATION OF 25 PERCENT SAFETY MARGIN. WHEN PRESSED FURTHER, HE EXPLAINED THAT BANK PROJECTIONS ASSUME THAT U.S. WILL SUBSCRIBE TO REMAINING TWO-THIRDS OF FIRST CAPITAL INCREASE BY

MID-1977 AND THAT SPECIAL CAPITAL INCREASES FOR CANADA AND GERMANY WILL BECOME EFFECTIVE BY MID-1977. IF THESE ASSUMPTIONS ARE ONLY PARTIALLY FULFILLED, HE SAID, THE BANK WILL NEED TO USE MOST OF 25 PERCENT SAFETY MARGIN TO CONTINUE DISBURSEMENTS. ANOTHER QUESTION WAS WHETHER INVESTORS ACTUALLY CONSIDER 25 PERCENT SAFETY MARGIN AS IMPORTANT TO THEIR DECISION TO PURCHASE ADB BONDS. GERMAN ALTERNATE DIRECTOR SAID THAT IN HIS RECENT DISCUSSIONS WITH GERMAN BANKERS, HE WAS TOLD THAT ONLY CONSIDERATION WOULD BE GOVERNMENT GUARANTEES. WHEN ASKED WHY ADB BOND INTEREST RATES AND MATURITIES WERE NOT AS FAVORABLE AS THOSE OFFERED TO WORLD BANK, GERMAN ALTERNATE DIRECTOR SAID THAT GERMAN BANKERS WERE NOT FAMILIAR WITH ADB AND BELIEVED THAT POLITICAL INSTABILITY IN REGION CREATED RELATIVELY MORE UNCERTAINTIES. ADB VICE PRESIDENT ADDED THAT WHILE IBRD DOES NOT HAVE AN EXPLICIT RULE, COMPUTATION REVEALS SAFETY MARGIN OF ABOUT 25 PERCENT. ADB PRESIDENT EXPLAINED THAT NEW YORK BOND RATING AUTHORITIES ARE MORE FAVORABLY IMPRESSED IF FINANCIAL RATIOS AND POLICIES COMPARABLE TO PRIVATE FINANCIAL INSTITUTIONS ARE MAINTAINED. FOR EXAMPLE, ADB GENERAL COUNSEL EXPLAINED THAT STATE INSURANCE COMMISSIONS IN U.S., WHEN CONSIDERING RULINGS ON ADB BOND ISSUES FOR INSURANCE COMPANY INVESTMENTS, SPECIFICALLY REQUIRE INTEREST COVERAGE OF 1.5 OVER TIME PERIOD AS TEST OF FINANCIAL VIABILITY.

6. DISCUSSION OF WORKING PAPER II AND ADDITIONAL SUMMARY PROVIDED IN WORKING PAPER IV DATED 5 FEBRUARY FOCUSED ON CASE 9 WHICH INCLUDES 135 PERCENT CAPITAL INCREASE, 10 PERCENT PAID-IN AND 40 PERCENT CONVERTIBLE CURRENCY PORTION OF PAID-IN, AND ON IMPLICATIONS OF LIMITED OFFICIAL USE

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INADEQUATE BANK INCOME IF FINANCIAL INDICATORS WERE NOT CHANGED. POSSIBILITIES OF CHANGES IN LENDING RATE, COMMITMENT CHARGES AND INTEREST RATES TO IMPROVE BANK INCOME WERE DISCUSSED.

7. ADB PRESIDENT CONCLUDED DISCUSSION BY ANNOUNCING THAT BANK STAFF WOULD PREPARE INFORMAL DRAFT REPORT OF BOARD OF DIRECTORS AND DRAFT RESOLUTION OF BOARD OF GOVERNORS AND DISTRIBUTE THEM TO BOARD OF DIRECTORS PRIOR TO MEETING SCHEDULED FOR 16 MARCH TO CONSIDER SPECIFIC ADDITIONS OR CORRECTIONS IN LIGHT OF POSITIONS OF MEMBER GOVERNMENTS. USADB REQUESTS NAC GUIDANCE ON BANK PROPOSAL TO INCREASE CAPITAL FOR 16 MARCH MEETING. SULLIVAN

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PAPERS, POLICIES, BANKS, MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 17 FEB 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: morefirh
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976MANILA02302
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D760058-0806
From: MANILA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760243/aaaablyn.tel
Line Count: 168
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION TRSE
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 76 MANILA 1540
Review Action: RELEASED, APPROVED
Review Authority: morefirh
Review Comment: n/a
Review Content Flags:
Review Date: 07 JUN 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <07 JUN 2004 by greeneet>; APPROVED <01 JUL 2004 by morefirh>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: REVIEW OF BANK'S RESOURCE POSITION AND PROPOSAL FOR AN INCREASE IN THE BANK'S CAPITAL STOCK
TAGS: EAID, EFIN, RP, ADB
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006